A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

THE 2009/2010 AUDIT OF THE SCOTTISH GOVERNMENT CONSOLIDATED ACCOUNTS

1. The Scottish Government Consolidated Accounts incorporate the activities of the seven core portfolios supported by Administration, the Crown Office and Procurator Fiscal Service, all 11 executive agencies, and the NHS bodies in Scotland responsible for the planning, promotion and commissioning of health care. I submit these accounts and my report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.

2. The accounts for the year ended 31 March 2010 are not qualified. My audit report includes my opinion that the financial statements give a true and fair view in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the directions made thereunder by the Scottish Ministers. It also includes my opinion that the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers.

3. The audit of the accounts was completed to allow them to be signed on 17 September, earlier than in previous years. This was a significant achievement, particularly in the first full year of application of the International Financial Reporting Standards (IFRS).

4. The Budget Bill for 2009/10 was approved by Parliament in February 2009. The budget was subsequently revised following due Parliamentary process in an Autumn Budget Revision (ABR) in December 2009 and a Spring Budget Revision (SBR) in March 2010. Overall, the Scottish Government and associated bodies managed their budgets well with outturn being within one per cent of budget as a whole.

Background to the report

5 In my report *'Scotland's public finances: Preparing for the future'* published in November 2009, I suggested that the Parliament should consider whether the Public Audit Committee (PAC) should be asked to scrutinise the audited accounts of the Scottish Government and make a report on any matters arising. In March 2010, I briefed the PAC on how the accounts could be used to inform Parliament's budget scrutiny and how Audit Scotland could assist this process by providing analysis of variation between outturn and budget. The PAC welcomed this proposed approach.

6. The Scottish Parliament has an important role in scrutinising Scottish Government spending plans and approving its budget. The Scottish Government's spending plans are usually published in the September preceding the financial year in question followed by a Budget Bill and supporting document which is usually presented to the Scottish Parliament in the following January. Supporting documents provide additional detail of proposed spend at what is known as Level 2 and Level 3 although there is no statutory requirement for the Scottish Government to stay within these lower level budgets[1]. There is no formal requirement for the Scottish Government's consolidated accounts or any other document to report the outturn at the end of the financial year compared with budget at Level 3. However, subject committees might find it useful to

[1] Levels 2,and 3 relate to the cascading of budgets across the Scottish Government. The lowest budgetary level which is published is Level 3 which typically reflects individual activities that contribute to the spending programmes reported at Level 2.

have information at this level to inform their consideration of the budgets for future years. One purpose of this report is to provide some more detail on variations between outturn and budget than is contained in the accounts.

7. The UK Government's ongoing Spending Review means that the Scottish Government's proposed spending plans for the four years commencing 2011/12 are likely to be published in mid-November 2010. It is anticipated that the UK Spending Review will lead to significant reductions in the Scottish Government's budget over the coming years. This report is partly intended to help inform scrutiny of the 2011/12 spending plans and also the 2010/11 ABR and SBR[2].

The Scottish Government's budget

8 The Budget (Scotland) Act is an annual Act passed by the Scottish Parliament which sets a statutory budget limit for each portfolio of the Scottish Government. It also sets statutory budget limits for other bodies included within the Scottish Administration, such as the Crown Office and Procurator Fiscal Service, and four directly funded bodies[3]. The Act also sets overall limits on the amount of cash which the Scottish Administration and directly funded bodies can draw-down from the Scottish Consolidated Fund.

Developments in reporting on the Scottish budget

9. It is important that that the financial information provided to Parliament is timely, relevant and understandable. HM Treasury has a current project called 'Clear line of Sight' which aims to simplify the presentation of budgetary information to Westminster[4]. This is expected to contribute to better government through improved democratic involvement for, and accountability to, Parliament and the public. It is also expected to help to develop more coherent presentation of financial reporting documents that meets the needs of government and Parliament, and is consistent with best practice in the private sector.

10. In recent years the Scottish Government has made a number of improvements to the way in which financial information is presented to the Scottish Parliament:

- More detailed tables in the supporting documents to the Budget Bill and to the ABR and SBR which reconcile cash and resource budget figures and provide a reconciliation from the draft Budget to the Budget Bill and to the consolidated accounts

- Preparation of explanatory guides to the ABR and SBR to assist parliamentary interpretation

- Provision of more detailed financial information, for example provision of some Level 3 budgetary information as a matter of routine

Changes made to the 2009/10 budget

11. There was a technical change during the year in accounting for National Insurance contributions. The Scottish Government has no control over the level of National Insurance contributions it receives from HM Revenue and Customs. This sum had been

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[2] The Scottish Government can amend its budget as required during the financial year. Generally, the Autumn and Spring Budget Revisions are presented to Parliament in October and January respectively. Supporting documents detailing proposed changes from the previous figures approved by Parliament are provided for all revisions.

[3] The four directly funded bodies are the Forestry Commission, the Food Standards Agency, the Scottish Parliamentary Corporate Body and Audit Scotland.

[4] HM Treasury Clear Line of Sight – The Alignment Project http://www.hm-treasury.gov.uk/psr_clear_line_of_sight_intro.htm

treated as a source of income in the original approved budget but in the ABR it was accounted for as a separate source of funding[5] from HMRC. This had the effect of increasing the overall Scottish Government budget for 2009/10 approved by Parliament by £1,724 million but had no overall effect on the amount of funding available to the Scottish Government.

12. Excluding this £1,724 million, the Scottish Government's net budget increased by £440 million (1.4 per cent) from £31,689.6 million to £32,129.4 million between the original Budget Act and the SBR. All portfolios saw some change in their overall budgets with the largest increases in budget being in the Health and Wellbeing, Education and Lifelong Learning and the Local Government Portfolios. The Finance and Sustainable Growth, Justice and the Rural Affairs and the Environment Portfolios experienced the largest reductions in budget (Exhibit 1).

Exhibit 1: Changes to the 2009/10 Level 1 budget

Portfolios	Original Budget	ABR	SBR	Changes between SBR and Original Budget	
	£m	£m	£m	£m	%
Office of the First Minister	265	264	263	-2	-0.7
Finance & Sustainable Growth	3,394	3,429	3,368	-26	-0.8
Health & Wellbeing	12,160	12,415	12,542	382	3.1
Education & Lifelong Learning	2,787	2,908	2,925	138	5.0
Justice	1,845	1,807	1,772	-73	-3.9
Rural Affairs & the Environment	546	517	482	-64	-11.7
Local Government	10,301	10,368	10,380	79	0.8
Crown Office & Procurator Fiscal	119	119	120	1	0.7
Total Programme	**31,417**	**31,827**	**30,102**	**436**	**1.4**
Administration	273	274	277	4	1.4
Total Scottish Government	**31,690**	**32,100**	**32,129**	**440**	**1.2**
Health and Wellbeing – NI Contributions	**-1,724**	**0**	**0**	**1,724**	
Total Published Budget	**29,966**	**31,100**	**32,129**	**2,164**	**7.2**

Source: Scottish Government 2009/10 budget documents

13. At the next level down – Level 2 – changes between the SBR and original budgets were relatively common. Of the 65 Level 2 budget lines, 21 show significant changes between the SBR budget and the original budget[6].

14. In most cases, the changes to the original budget were made at the ABR although further changes at the SBR also occurred. While the supporting documents provide some explanation as to why budget changes are proposed at Level 2, it is not always clear as to which Level 3 budget line they refer. For example, the ABR and SBR supporting documents refer to technical adjustments of £292 million resulting from the implementation of IFRS but they do not stipulate which Level 3 budget lines are affected.

[5] The key difference between a source of funding and a source of income is that the former is not subject to Parliamentary authority and is therefore not capped.

[6] A significant variation is defined here as being when the SBR is greater than or less than £10 million and 5% of the original budget, or greater than or less than £20 million of the original budget.

15. In other cases, changes to Level 2 budget lines are explained in the supporting documents as being the result of Ministerial funding announcements. For example, in January 2009 the Minister for Finance and Sustainable Growth announced additional funding for the Town Centre Regeneration Fund (£60 million), Home Insulation (£15 million) and Modern Apprenticeships (£16 million). In respect of the Town Centre Regeneration Fund and Home Insulation, this resulted in new Level 3 budget lines within the Housing and Regeneration budget of the Health and Wellbeing Portfolio in the ABR. But it is not immediately clear that the additional Modern Apprenticeships funding resulted in an increase in the budget of Skills Development Scotland Ltd within the Education and Lifelong Learning Portfolio.

16. In most cases however, budget changes are the result of the transfer of resources within and between portfolios with limited explanation as to why they were necessary. The provision of more detailed information could allow Parliament to exercise more effective scrutiny by allowing MSPs to understand better the reasons for proposed budget changes.

The Scottish Government Consolidated Accounts

17. Details of the Scottish Government's expenditure during the year are contained in the Summary of Total Outturn which provides analysis of total (operating and capital) outturn against each portfolio's statutory budget limit and Level 2 budget lines (page 30 of the 2009/10 accounts). The accounts also contain individual portfolio outturn statements which provide analysis of resource outturn against budget (pages 32-40 of the 2009/10 accounts) and a single outturn statement detailing each portfolio's capital spend against budget (page 31 of the 2009/10 accounts).

18. The consolidated accounts also provide analysis of the reasons for major variances between portfolio outturn and budget (pages 41-42 of the 2009/10 accounts for resource outturn and page 68 for capital outturn). The explanations concentrate on reasons for variances at Level 2 although it can be difficult to reconcile the quoted variances back to the resource and capital outturn statements.

Variations between 2009/10 outturn and budget

19. The Scottish Government's overall net outturn for 2009/10 was within one per cent of budget. Net outturn amounted to £31,877 million against the Spring Budget Revision approved budget of £32,130 million, resulting in an underspend of £253 million. Resource underspends amounted to £314 million while there was a capital overspend of £61 million.

20. All portfolios were within their statutory budget limits. In two cases (Finance and Sustainable Growth and Health and Wellbeing) capital overspends were offset by resource underspends (Exhibit 2).

Exhibit 2: Outturn against budget 2009/10

Portfolio	Resource				Capital			
	Budget	Outturn	Variance		Budget	Outturn	Variance	
	£m	£m	£m	%	£m	£m	£m	%
Office of the First Minister	259	254	(5)	-1.9	4	1	(3)	-75.0
Finance & Sustainable Growth	2,858	2,764	(94)	-3.3	511	533	22	4.3
Health and Wellbeing	11,807	11,661	(146)	-1.2	735	795	60	8.2
Education & Lifelong Learning	2,805	2,759	(46)	-1.6	120	103	(17)	-14.2
Justice	1,634	1,620	(14)	-0.9	138	134	(4)	-2.9
Rural Affairs & the Environment	478	479	1	0.2	4	1	(3)	-75.0
Local Government	10,380	10,378	(2)	0	0	0	0	0
Crown Office and Procurator Fiscal	113	113	0	0	7	6	(1)	-14.3
Total Programme	**30,334**	**30,028**	**(306)**	**-1.0**	**1,519**	**1,573**	**54**	**3.6**
Administration	269	261	(8)	-3.0	8	15	7	87.5
Total Scottish Government	**30,603**	**30,289**	**(314)**	**-1.0**	**1,527**	**1,588**	**61**	**4.0**

Source: Scottish Government Consolidated Accounts 2009/10

21. There are many reasons why outturn will not exactly match budget. For example, some budget lines are demand-led and hence the level of demand will affect outturn. In other cases, the development and implementation of policies and projects may be faster or slower than anticipated with the result that expenditure is greater or less than estimated. Furthermore an approved level of overallocation is built into the total budget in order to help minimise the level of underspending. It is neither possible in a report of this size nor is it appropriate, to provide analysis of every variation between outturn and budget. I have, therefore, decided to report only significant variances at the Level 2 budget line, where 'significant' is defined as a variance between outturn and budget of at least £10 million and 5 per cent of budget.

22. There were 11 instances in 2009/10 where net resource outturn varied from budget by more than £10 million and five per cent of budget at Level 2. Capital outturn also varied from budget by more than £10 million in three portfolios. Analysis of these variances indicates they can be grouped into four main categories:

- Variances as a result of technical accounting adjustments

- Variances as a result of budget classifications

- Variances as a result of amendments to provisions

- Other differences reflecting real variances in spend or activity against budget.

The following paragraphs look at these variances in more detail.

Variances as a result of technical accounting adjustments

23. Variances between outturn and budget can sometimes arise as a result of the difficulty in estimating the value of expenditure lines which are dependent on a number of assumptions. This tends to affect non-cash items such as depreciation and capital charges which are dependent on the value of fixed assets on which they are calculated. This resulted in two instances of significant variances between outturn and budget at Level 2 in the Finance and Sustainable Growth Portfolio:

    - Motorways and Trunk Roads - resource outturn of £302 million exceeded the resource budget of £279 million largely as a result of increased roads depreciation. The charge is affected by a model used by Transport Scotland to value the trunk road network. The model relies on the collection of data on technical measurements taken during the year on, for example, road condition and is also subject to a considerable number of assumptions.

    - Motorways and Trunk Roads (capital charges) - resource outturn of £538 million against budget of £589 million. The cost of capital charge is dependent on Transport Scotland's roads asset valuation model together with forecast depreciation, revaluations and net additions to the trunk road network. The budget is estimated as a 3.5 per cent charge based on projected valuation. Outturn is difficult to predict and is treated as Annually Managed Expenditure to recognise the difficulties in budgeting.

24. Variances can also result from the introduction of revised accounting standards. The introduction of IAS 32 Financial Instruments during 2009/10 contributed to an underspend of resource outturn of £251 million against a budget of £266 million within the Other Lifelong Learning Level 2 budget line of the Education and Lifelong Learning Portfolio. This was largely due to negative capital charges associated with the impairment adjustment on student loans. At the time the budget was set, it was not clear whether this capital charge would need to be made.

Variances as a result of budget classifications

25. In two cases variances at Level 2 were, at least in part, due to expenditure being recorded as capital when the budget had been established as a operating budget:

    - The Health and Wellbeing Portfolio Housing and Regeneration Level 2 budget line reported a resource outturn of £629 million against a budget of £725 million, while a capital overspend was reported with outturn of £795 million against a budget of £735 million. This was due to the shared housing equity scheme within the Affordable Housing Investment Programme which provides loans for those on low income who cannot raise enough funds to purchase a house even on their maximum mortgage. A review of accounting for this scheme in 2009/10 concluded it should be capitalised as a financial instrument.

- The Education and Lifelong Learning Portfolio Children, Young People and Social Care Level 2 budget line reported a resource outturn of £93 million against budget of £118 million, partly due to £13 million recorded as capital expenditure although it was budgeted for as resource expenditure. This relates to Disclosure Scotland's establishment of a new IT system to support its responsibilities under the Protection of Vulnerable Groups (Scotland) Act 2007.

Variances as a result of amendments to provisions

26. Provisions are created in the accounts of a body in recognition that it has a liability which it is likely to have to meet at some point in the future. They are essentially best estimates and are regularly revised as more information becomes available at the year end. A provision increases outturn for the year but it does not involve a cash outflow. Instead, it assumes that the cash required to meet the liability has been put to one side until such a time it is required. Failure to provide adequately for future liabilities could result in the body having insufficient funds when they are required.

27. There were two instances in the Scottish Government's 2009/10 accounts of provisions being revised which resulted in significant variations between outturn and budget:

- The Finance and Sustainable Growth Portfolio reported capital outturn of £533 million against a budget of £511 million. The overspend was largely the result of an increased provision in respect of land acquisition to allow completion of the M74 and the M80 Stepps to Haggs project and increased associated capital expenditure on the M74 completion project which was ahead of schedule.

- The Rural Affairs and Environment Portfolio EU Support and Related Services Level 2 budget line reported resource outturn of £172 million against a budget of £136 million. This was largely as a result of the creation of a £39 million provision for potential EU disallowance of expenditure relating to the European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development.

Other general underspends against budget

28. There were also a number of other variances across portfolios:

Finance and Sustainable Growth Portfolio

- Rail Services in Scotland – resource outturn of £639 million against a budget of £661 million. This was due to reduced payments by Transport Scotland to ScotRail Ltd as a result of a recent rail industry wide recalculation of track access charges and reduced performance payments of £1.8 million as a result of the bad winter of 2009/10 which affected punctuality performance.

- Other Transport Directorate Programmes – resource outturn of £14 million against a budget of £46 million as a result of the release of a provision which was no longer required (£20 million) and lower than expected take-up of Freight Facilities Grant (£12 million).

Education and Lifelong Learning Portfolio

- Children, Young People and Social Care - resource outturn of £93 million against a budget of £118 million. In addition to a change in the budget classification highlighted in paragraph 24, the two other factors that contributed most to the underspend were:

i. The High Risks and Transition programme which compensates local authorities for unused capacity within secure accommodation had an underspend of £1.5 million because more children were placed in secure accommodation than expected.

ii. The Scottish Social Services Council generated extra income from registration fees due to more registrants than anticipated and less expenditure from reduced numbers of social work students and associated bursary costs. The effect was an underspend against budget of £1.1 million.

Rural Affairs and the Environment Portfolio

- Research Analysis and Other Services - resource outturn of £72 million against a budget of £84 million as a result of the non-cash budgets for research institutes not being required and lower than expected transition costs for a new institute which will take over the functions of other bodies and which carry out programmes of research into crops and land use. It will be established in April 2011. There was also a £1.4 million underspend on the Contract Research Fund due to fewer projects than expected coming to fruition.

- Marine and Fisheries - resource outturn of £52 million against a budget of £62 million was largely the result of higher income levels and lower than expected spend by Marine Scotland across a number of budget lines.

Administration Portfolio

- Directly Employed Staff costs – resource outturn of £164 million against a budget of £179 million as a result of vacancies not being filled in anticipation of future budget reductions. This was offset by an overspend of £9 million on other staff costs, which included the cost of early severance agreements, and £7 million capital on other spend to save measures, such as new lighting for Scottish Government buildings designed to lead to cost savings in the medium/long term.

Conclusions

29. Overall, the Scottish Government and associated bodies managed their budgets well in 2009/10 with outturn being within one per cent of the budget as a whole. Below this level i.e. at individual Level 2 and 3 budget lines, some variance between budget and outturn is always likely to occur.

30. In 2010/11 the Budget Act has been amended to maintain budgetary limits for all portfolios but to recognise that the Act will only be breached if the total for all portfolios is breached. It is important that this change does not result in less detailed information to support the Parliamentary scrutiny process.

31. Given the likely financial constraints that the Scottish Government will face in the coming years, it is more important than ever that high-quality and detailed financial information is made available so that Parliament can exercise adequate scrutiny of the proposed budget. With this in mind, there is scope for:

- Improved clarity of reporting to Parliament of the reasons for proposed budget changes at the ABR and SBR

- Provision of more detailed financial information to Parliament on outturn against budget. Subject committees in particular may find it useful to receive more detailed reports on portfolio outturn, and results achieved from spend, as part of their scrutiny of subsequent years' budgets.

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28 September 2010